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Bush tax cuts 'may sap confidence'

By Christopher Swann in London
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BANK FOR INTERNATIONAL SETTLEMENTS

The Bush tax cuts risk undermining confidence in the health of US public finances, according to the Bank for International Settlements, the forum for the world's central banks.

The BIS said in its annual report that the Bush administration and the US Federal Reserve had been right to take action to boost the economy.

But it said the $350bn tax cuts package agreed by Congress had "not been helpful" and there was a danger that debt would reach unsustainable levels.

The BIS warned that the US risked exacerbating imbalances in the US economy which could result in a painful correction in the future. The Fed may have contributed to new imbalances, the report suggests, by fuelling a rise in house prices with its steep interest rate cuts which have led to a further build-up of debt.

The sharp reversal in US government finances has become a growing source of concern. The latest official forecast for 2003 is for a deficit of more than $400bn, compared with a budget surplus of $236bn in 2000.

The BIS urges the US to adopt a system to guarantee the sustainability of government debt, along the lines of the eurozone's stability and growth pact - although it criticises the pact as too inflexible.

Its report also echoes private-sector economists' concerns that the US government may be reluctant to rein in fiscal policy when the economy is out of danger.

"The tax cuts should have been more short-term and reversible," said George Magnus, global economist at UBS. "Long-term commitments to social security will also weigh heavily on public finances," he added.

The report suggests that the US is much less likely to succumb to the deflationary problems that have blighted the Japanese economy. While the Japanese asset bubble of the 1980s was fuelled by Japanese money, the US bubble of the late 1990s was financed by funds from abroad.

As a result, the deflationary threat was more serious in the countries such as the eurozone than in the US itself, the report argues.

In spite of the steep fall in the dollar over the past year, the BIS said the US currency was not out of danger and the size of the current account deficit would continue to weigh on it.

Slower economic growth in the eurozone and Japan meant that any improvement in the current account position was likely to be slow.

Vedomosti
CBS MarketWatch
Investors Chronicle

"Currencies that are floating more freely [in particular the yen and the euro] might come under substantial upward pressure," the report warns.

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